Attractiveness of Chinese Consumers

The China market has been tantalizing to westerners since Marco Polo. By virtue of its size and the stage of economic development, the potential for many products can be a factor of 10, 100 or even more. China is generally regarded as a large and homogeneous population with rapidly increasing income and an insatiable appetite for foreign goods. In the last twenty years, the prospect of reaching one fourth of the world's population has attracted many MNCs to converge in China and to quickly take positions there in order to block out slower-moving competitors. The presumably homogeneous population with a common language and cultural heritage, reinforced by decades of Communist rule, promises opportunities for rapid growth and expansion. Centralized media and national TV networks make standardized advertising plausible for the entire market.

Since the beginning of reforms in late 1970s, the Chinese economy has experienced tremendous growth, at about 10% per annum. Based on World Bank estimate, China's GNP reached $860 billion in 1997. At the micro-economic level, per capita income among urban households reached 4,377 RMB ($530) in the same year. While China's geographic area is slightly bigger than that of the United States, its 1.25 billion people mostly live in the eastern provinces along the coastline, making it a very dense market. The Chinese language is the same for Han Chinese, 94% of the country's population. This commonalty has led many to believe that Chinese consumers are largely homogeneous[1].

Foreign-funded manufacturing companies have been permitted to sell their output in the domestic market as long as they balance their foreign exchange. Since 1992, China has welcomed broad-based foreign participation in its retail sector. Rapid increase in consumer income and changing spending patterns have driven up sales of many consumer goods. China's retail market has been growing at a rate of more than 20% a year, from $150 billion in 1993 to $360 billion in 1998. Sales of cosmetics, for instance, grew from 9 billion RMB in 1994 to 18.2 billion RMB in 1996. Attracted by these rapidly multiplying figures, ambitious multinational retailers have opened hundreds of retail outlets in China. Considering their expansion plans, however, most food and beverage retailers must believe the market has great potential. Japan's Hong Kong-based Yaohan had plans to open 1,000 supermarkets in the Yangtze River Basin and 3,000 fast-food outlets throughout the country. Another Japanese retailer, Daiei, planned to open 300 supermarkets. Over the next decade, McDonald's expected to open 600 outlets. Pizza Hut's plan to open 300 outlets by comparison modest[2].

Certain segments of the society are particularly attractive for foreign marketers. In recent years, several studies have surveyed the Chinese consumers to assess their purchasing power. In a 1994 study of 280 well-off people in Shanghai and Guangzhou, Roper Research International found that these “super consumers” earned 10 times the average annual income in China, and 85% of them preferred to pay cash[3]. Many of these supper consumers were entrepreneurs, professionals in private companies, and workers in township enterprises. In 1995, the Coopers & Lybrand conducted three focus groups in Shanghai, one of the more prosperous cities of China, with young women in their late teens and early twenties, and middle-aged women and men. The groups had average disposable income of some $4000 a year[4]. Recently, McKinsey & Co., the multinational consulting firm, reported that there were at least 60 million Chinese with an annual income over $1,000, and perhaps one million millionaires in Chinese currency[5].

After the initial euphoria with the fabled market, the reality of limited growth set in. A significant number of MNCs operating in China have not been profitable. The optimistic misconception of a large and homogeneous population with increasing disposable income and insatiable appetite for foreign goods has led to rapid expansion, which often overshoots the local demand. Attempting to approach the market with a monolithic view of Chinese consumers is at best inadequate, and has led to returns less than satisfactory.

An important indicator of attractive market opportunities, found in Newly Industrialized Countries (NICs) including Taiwan and Hong Kong, is a growing and affluent middle class looking for quality products. Despite its recent economic boom, China is largely a developing country and hardly represents a single market. First, the retail boom has largely an urban phenomenon. The majority of mainland Chinese are still farmers and poor working people, who often have little to spare[6]. The vast rural market has been ruled out as far as foreign goods are concerned. Thus, focusing on the rising income alone as a sign of market readiness creates an inaccurate perception of the opportunities and risks there.

Before the reforms, compensation was mostly set by the government, and there were little difference in people's purchasing power. As the

Chinese government has not officially abandoned the ideal of a classless society, social class is perhaps not a politically correct term. However, since the beginning of the reforms, disparity in people's income has widened, and the gap is becoming larger[7]. Following Deng's adage "to let some people get rich first," many Chinese have enjoyed the tremendous opportunities brought by the reforms, particularly those in coastal cities and those who have departed from the government as their permanent employer. Many people have prospered after they started their own businesses or sought employment with private enterprises, where compensation is linked to one's performance.

The profile of a “super consumer,” however, hardly represents the average Chinese, who is mostly likely in the twenties, with limited income, living in an apartment with their parents. In a national consumer survey in mid 1994, Gallup China Ltd. interviewed 3,400 people representing the entire adult population of the country[8]. The study suggests that while Chinese consumers clearly prefer foreign goods, which are often of better quality, they are far more value conscious than anticipated and would not simply buy anything foreign. Most Chinese consumers are rather pragmatic and plan carefully for purchases. Therefore, firms need solid information on the specific market or sector, and make sure that they get the right numbers.

However, understanding of China's economy and market, present and future, is a daunting task. Even the definition of base-line "realities" is subject to great controversy and can cause a lot of confusion[9]. Measured from a very small base, the grow rates of many sectors are substantially higher than those of developed economies. One sets of forecasting, which are particularly confusing if not misleading, is based on the Purchasing Power Parity (PPP) in a report released by the World Bank, which fueled the enthusiasm about China. The PPP exchange rate takes into account the relative prices of goods and services that are not traded internationally. As an example, the relative prices of hair cuts or hospital visits are essential to PPP estimates, but not relevant to conventional foreign exchange rate calculations.

Based on the Purchasing Power Parity calculations, China already became the world's second-largest economy in 1995, surpassing Japan with a GDP in excess of $2.7 trillion(1) or roughly 30% of the U.S. equivalent. However, using the conventional method of exchange rate, China's GDP was about $520 billion, only a small fraction of that of Japan. Under the PPP method, during 1994, China's economy expanded 12%, with foreign trade totaling $235 billion, new foreign investment hitting $35 billion, and foreign exchange reserves surpassing $50 billion. Yet, conventional measures of annual per capita income in 1994 suggest dire poverty: $360 in urban areas and $165 in rural areas.

Another major indicator of market growth is urbanization, which led to increasing demand in infrastructure and a whole array of other investments. Rapid urbanization have fueled the exponential growth of many small towns and cities, and swelled up the big cities. About 300 million "peasants" stand poised to leave the countryside and flood China's urban areas. Thus, Chinese government planned in 1998 to spend up to $1 trillion on infrastructure over the next 10 years, with Shanghai municipality alone slated for a $100 billion investment. With 400 million denizens, urban China today has no rival other than India. By the year 2010, the urban market will swell to 700 million, fed by rural to urban migration unprecedented in human history. Although this demographic forecast appears venturesome, it requires an urban population growth rate of only 4% a year for the near future, or a mere extension of recent trends. Gross yearly retail sales, already approaching $1 trillion, will double within a decade.

Assertions about present and future output and income are even bolder under the PPP method. The Chinese Yuan has a foreign trade-linked exchange rate value of $0.12. By that yardstick, China's output was relatively small ($520 billion) in 1995, and per capita or household incomes are only large enough for a few weeks' subsistence in a dollar-denominated environment. However, many economists prefer an alternative measure of the Yuan, which yields a Purchasing Power Parity (PPP) equivalent value of $0.54, or a GDP of $2.7 trillion. Using PPP conversion rates, and assuming that urban areas now carry a weight in GDP creation twice their overall demographic proportion, then roughly two-thirds of China's GDP, or $1.8 trillion, is urban -- larger than any other economy except for those of the United States, Japan, and Germany.

Similarly, average annual urban household cash incomes for a "statistical" family of 3.3 now top $6,000, with some coastal cities reporting levels at or slightly above $9,000. Adusting for in-kind benefits such as housing and medical care, the wealthiest 20% of households in urban areas earn, on average, constituting a middle-class market of approximately 70 million-80 million individuals. Even a relatively modest annual growth rate of 7% will yield a GDP of $7.5 trillion by 2010, with the urban share rising over time. Average household incomes for a family of three will grow by at least 5% per year and exceed $11,000 by 2010, heralding the arrival of a middle-class urban society across China.

Based on such rosy forecasts, it is not surprising that many went to China with a "gold rush" mentality. Today, many people believe that

these measures grossly exaggerated the buying power in China by a significant margin[10]. The PPP measures are meaningful for measuring the purchasing power of consumers who buy locally produced products at local prices. Transferring the purchasing power into a different country at different prices would produce different results. An upscale Chinese family with a $9000 household income would live under the poverty line in the U.S.. Likewise, demand under PPP measures would be meaningful for foreign investors only they can make similar products at local costs and sell them at local prices. Thus, those forecasts, though encouraging, need to be discounted perhaps by 50%. Many companies have to adjust their expectations.

In addition, statistics from Chinese sources are often inflated for political purposes. It's easier to gauge the spending plans of infrastructure investors--overwhelmingly public sector in origin or sponsorship--than to fathom consumer behavior. Market research is still in its infancy, and published results are few. Even though the State Statistical Bureau surveys around 35,000 households across China's urban areas on a periodic basis to keep track of expenditures on goods and services, much of the information is of limited use because it is overaggregated[11]..

In recent years, the increasing income disparity has led some to believe that the real opportunities in China are either mass market items of low price and functionality or high-price specialties appealing to a very small group of affluent Chinese[12]. Furthermore, China's regional differences in economic development, infrastructure, distribution and transportation logistics, can erect major obstacles for MNCs to exercise a standardized approach to the market. In addition, the Chinese also have diverse cultural patterns exhibited by variations in dialects, taste, temperament and lifestyles. For detailed discussion, please refer to Chapter 5.

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